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SUMMARY ANALYSIS OF THE  
PSSC REVISED COMPREHENSIVE PROPOSAL  
TO THE  
COMMUNITY REDEVELOPMENT AGENCY  
OF THE  
CITY OF UNION CITY

JANUARY 18, 1996


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**SUMMARY ANALYSIS OF THE**  
**PSSC REVISED COMPREHENSIVE PROPOSAL TO**  
**THE COMMUNITY REDEVELOPMENT AGENCY**  
**OF THE CITY OF UNION CITY**

The City of Union City has requested that Coopers & Lybrand, L.L.P. ("C&L") assist the City by providing expert financial analysis services to the Community Redevelopment Agency of the City of Union City ("RDA"). The purpose of our analysis is to assist the RDA in analyzing options to provide gap financing and/or loan assistance to Pacific States Steel Corporation ("PSSC" or the "Company") and PASSCO Development Corporation ("PDC") in connection with the remediation and development of sites within the Decoto Industrial Park Study Area ("DIPSA").

PSSC has submitted a financing proposal, the Revised Comprehensive Proposal (the "Proposal") to the RDA. C&L's role on behalf of the RDA is to assist the RDA in evaluating the Proposal. Since the inception of our work on this endeavor, the RDA has also requested that we perform additional tasks, including reviewing an independent appraisal of the PSSC Property performed by Hulberg & Associates (the "Hulberg Appraisal") and assisting the RDA in evaluating PSSC's Amended Plan of Reorganization submitted to the Court.

This summary details C&L's observations with respect to the Proposal. This summary is intended to present our general observations with respect to the Proposal, rather than to make recommendations regarding any specific attributes of the Proposal at this time.

In connection with our analysis, C&L has reviewed the Proposal and participated in discussions with Mark Lewis, City Manager, Kerry Burns, Redevelopment Agency Manager, and John Holan of the Community Development Department. We have also met with Bruce Train and Ted Sorensen, and have toured the PSSC Plant Site portion of the Property. Additionally, we have reviewed salient documentation relating to the Proposal, including Owner Participation Agreements, the City of Union City Community Redevelopment Plan and the PSSC 1995 Amended and Restated Reorganization Plan (the "Amended Plan"), and numerous other documents.

This summary report includes an executive summary that identifies key issues and concerns with respect to the Proposal. The executive summary is followed by a more detailed discussion of the project, the parties and the Proposal.

The detailed discussion first describes the history of the PSSC Site and the various parties involved in its cleanup and development. In the following section, the funding request itself is described, and a discussion of conceptual and financial issues relating to the Proposal are explored. Finally, the RDA's role in the development is discussed. Recommendations for further action steps by the RDA are presented at the end of the report. Please note that C&L's recommendations are not intended to direct the RDA's course of action with respect to the Proposal, but rather are suggested investigatory steps whereby the RDA can further explore certain aspects of the Proposal.





## **EXECUTIVE SUMMARY**

The Redevelopment Agency of City of Union City has requested Coopers & Lybrand's assistance in evaluating the Revised Comprehensive Proposal (the "Proposal") received from Bruce Train, in his capacity as Special Master of Pacific States Steel Corporation. The Proposal requests funding from the RDA for the remediation and development of the PSSC Property located in Union City.

The Proposal is extremely complicated, and at times, inconsistent. As such, our summary report is quite long. This executive summary attempts to highlight certain issues that we feel have the most gravity.

### **Conclusion**

The RDA's goal in this endeavor is to remediate and assist in the redevelopment of the Plant Site. The structure of the Proposal does not necessarily provide appropriate development incentives for the RDA to attain its goal. Subarea 2C and Subarea 7 provide more lucrative near-term development opportunities than does the Plant Site. The Proposal provides that the RDA is responsible for additional project costs due to inflation or project overruns. Therefore, given that PASSCO bears none of the project's development risk, the Proposal provides incentives for PASSCO to use RDA funds on profitable development (ie., Subareas 2C and 7), rather than on development of the Plant Site.

*Simply stated, the Proposal is structured such that the RDA could fund \$35.75 million and more, but still not reach its redevelopment goal with respect to the PSSC property.*

**Financial estimates.** The Proposal presents a summary of sources and uses of project financing. There is little correlation between the amounts discussed in the body of the Proposal and the financial exhibits. Additionally, the Proposal does not present pro forma cash flow estimates which address the timing of sources and uses of cash over the development period. This type of analysis is typically performed for development projects of any significance. C&L met with Bruce Train and Ted Sorenson and requested a more conventional analysis than the schedule provided, but was told that it is "not possible" to create a pro forma cash flow for the project. The analyses provided are not as of a specific point in time, and confuse cash and non-cash inputs to the project.

Given the inconsistencies between the narrative and financial exhibits and the unconventional nature of the exhibits, the Proposal does not adequately detail the timing, flows, and uses of cash over the development period and may be misleading.





**Contingencies.** The stated amount of the funding request is \$35.75 million. However, per the terms of the Proposal, the RDA will be responsible for numerous additional sums and contingencies which cannot be quantified in advance. First, the Proposal enumerates a number of additional requests for infrastructure funding, fee credits, and the payment of sums to PSSC/PASSCO if certain events do not occur as planned. Additionally, the RDA will be responsible for increases in project cost due to inflation and project overruns. Not only does this impose unhealthy incentives upon PSSC/PASSCO, but the monetary effect on the RDA and the City could be substantial.

**Potential conflicts of interest.** Bruce Train was appointed by the Court as a Special Master with the charge of settling the matters of PSSC, including providing medical benefits to former employees. Train, along with Ted Sorensen and Hans Lemcke, formed PASSCO, a private company which contracts with the Special Master to perform administrative services for the Special Master. Additionally, the three have formed PDC, a development company owned and controlled by Messrs. Train, Sorensen and Lemcke, which will participate, as a partner, in the development of homes on the Property.

Significant conflicts appear to exist since Train in his capacity as Special Master, contracts services from PASSCO and PDC, in which he is a principal. A significant conflict exists between Train's fiduciary duty to strike the best possible deals for PSSC in all transactions, and his ownership of PASSCO and PDC.

In short, PASSCO receives fees for administering the PSSC estate and developing the Property, while PDC participates in the development profit from building homes on the PSSC Property. The fact that both of these entities are controlled by Bruce Train appears to pose significant conflicts. Additionally, since the interests of these entities in the project differ from that of the Pensioners and the RDA, the interrelationships between the entities may not be in the best interests of the Pensioners or the RDA.

**Development fees to PASSCO/PDC.** The Proposal provides for development fees to PASSCO in two ways: first, on an hourly rate basis, and second, as a value enhancement fee. Total hourly rate development fees, including paid, deferred and projected, approximate \$7.7 million. The projected value enhancement fee component of the development fee is \$12.3 million.

Typically, developers are compensated based upon the nature of a project and their capital at risk. The proposed fee structure provides for a significant value enhancement to PASSCO, while PASSCO does not have the capital risk that an owner/developer would have in a typical land acquisition/development deal. While the Proposal states that "PSSC/PASSCO is contributing \$47 million toward the estimated DIPSA costs of more than \$85 million", these amounts are not actual cash contributions representing capital at risk. Of this amount, \$30.7 million reflects the value of the land (per the Proposal and the KMA analysis) after remediation and infrastructure costs funded by the RDA. The remaining \$16.3 million relates to a portion of future profits to PASSCO from the development of the Property. The "inputs" contributed by PASSCO, have not been paid for by PSSC or PASSCO, and will essentially be funded or made available through the RDA. Simply stated, the structure of development fees should be based upon the equity





contributions and/or the capital at risk of the compensated party, considering market rate development fees and the complexities of the subject property.

***Administrative Fees to PASSCO.*** Per the terms of the Proposal, PASSCO is to receive hourly fees from PSSC for administration of the PSSC liability. It appears that the fees amount to \$4.6 million, including paid, deferred and projected fees. While administrative fees to a receiver or fiduciary are normally found in the marketplace, it is highly unusual for the fee to be billed on an hourly basis, particularly for a project of this duration. Hourly rate fees in the range of those charged by the Special Master, are not uncommon for part-time receiver related work for project durations of less than one-to-two years. With respect to the PSSC property, the full-time efforts of multiple individuals should warrant salary based compensation at levels substantially lower than the sum of the hourly rates presented by PASSCO. Bruce Train's roles with respect to both of the contracting entities invites questions with respect to the establishment and payment of this level of administrative fees.

In addition to hourly rate administrative and development fees, PASSCO has outlined hourly rate environmental fees totaling \$6.9 million (paid, deferred and projected). The gap funding analysis, which includes deferred and projected fees, indicates that total hourly rate fees (excluding past paid fees) for development, administrative and environmental services will amount to \$16.7 million. Of this amount, 50% is subordinated to a return of \$9 million to the PSSC Medial Plan.

***Developer incentives and land swap.*** The terms of the Proposal provide little incentive to PASSCO to complete development of the Plant Site. Per the PSSC/PASSCO development plan, the areas with the highest development potential (Subarea 2C and Subarea 7) are scheduled to be developed first. The Plant Site, which is the last area to be developed, is likely to generate the lowest development return due to its proposed uses which include public park areas, required infrastructure and environmental concerns.

PSSC/PASSCO argue that acquiring Subarea 7 will keep them "interested" in the project. In presenting a case for moving forward with the land swap in order for PSSC to obtain Subarea 7, Ted Sorensen stated that without allowing PSSC to obtain Subarea 7 via the swap, there is "no incentive for us to remain interested in the Plant Site after Subarea 2C is developed".

The land swap appears to focus the efforts of PSSC/PASSCO on the areas which can quickly provide profits from the development of the parcels through home-building (which will go to PDC and a joint venture developer) and not on the redevelopment of the Plant Site. It appears that in addition to the other disincentives in the Proposal, the land swap exacerbates the issue because acquiring Subarea 7 enables PASSCO/PDC to enjoy development profits, but does not provide incentives, funding, or profits to assist in the development of the Plant Site. (Subarea 7 is outside the DIPSA and the Redevelopment Project Area.)





*Correlation between purpose and use of funds.* Although C&L has not performed a detailed analysis of prior OPA's, it appears that some RDA disbursements may have been used on an interim basis for purposes other than the stated ultimate purpose, without a clear designation of an alternative funding source to achieve the ultimate purpose for which the RDA funds were granted. Of the approximately \$3.8 million which has been distributed to PASSCO, most was earmarked for remediation and cleanup of the Plant Site. It appears that some of the monies have been spent for purposes other than remediating the Property. In fact, portions of the completed remediation efforts (ie., by Rust) were not paid for in cash, and have had the effect of further encumbering the Property.

Per the RDA, the ultimate purpose for which the RDA has provided funds to PSSC through the 1994 OPA for Subarea 2C and the CIWMB Grant OPA are legally authorized under CRL. The RDA has obtained a first position deed of trust on fully remediated property in DIPSA Subarea 2C with value (per the Hulberg and KMA appraisals) in excess of the disbursed and committed funds to assure and enforce performance by PSSC of the obligations under the 1994 OPA for Subarea 2C. The CIWMB Grant OPA requires that performance occur prior to the release of funding.





## **BACKGROUND**

### **History of the PSSC Site**

Pacific States Steel Corporation began manufacturing rebar and other steel products in Union City in 1938. In its prime, PSSC was one of the largest employers in southern Alameda County. In 1978, PSSC ceased operating. It currently is an insolvent corporation, and its assets and affairs are under control of a Federal Court appointed Special Master as a result of a consent decree in a law suit filed on behalf of prior PSSC employees attempting to secure health and pension benefits (the "Pensioners"). As a result of the consent decree, a Special Master, Stephen Russell, was appointed by the Court to act as an officer of the Court. The primary charge of the Special Master was to develop and oversee the Plan and provide benefits to eligible persons, and address claim issues. The court order provided for bi-monthly reporting to the Court.

On November 10, 1988, a Plan of Reorganization was approved by the Court, which provided for development of the PSSC Property. On November 11, 1990, Bruce Train replaced the original Special Master, with the charge of continuing the development of the Property as envisioned under the plan with the goal of providing benefits to the Pensioners.

Although PSSC did have other assets at the time that the original Special Master was appointed, the PSSC Property is now the Company's only asset. Due to the nature of the prior uses of the PSSC Property while it was in operation, portions of the Property have environmental contaminants which require significant cleanup and remediation expenditures. A specific plan for the development of this area has been approved by the City Council and a Remedial Action Plan has been approved by Department of Toxic Substances Control ("DTSC").

It is our understanding that, from the perspective of the RDA, the purpose of the Redevelopment Plan is to facilitate the cleanup and remediation and to promote the rehabilitation and redevelopment of the PSSC Property. Remediating the PSSC Property will remove the public health hazard resulting from the contamination, put a non-productive site back on the tax rolls, and create a site for additional development.

From the perspective of the Court and the Special Master, the purpose of redeveloping the Plant Site is to provide some return from the development of the only remaining asset of PSSC (the PSSC Property) and to provide health benefits to the Pensioners.

To date, the RDA, through two Owner Participation Agreements, has committed \$6,467,300 in funding toward the remediation and development of the site. These amounts include a \$500,000 matching grant from the California Integrated Waste Management Board (CIWMB). The CIWMB Plant Site Cleanup Grant OPA totaled \$1,267,300 and has been fully committed/funded.





The 1994 OPA for Subarea 2C provided for up to \$5.2 million to be funded in five disbursements based upon the performance of certain stipulated tasks by PSSC/PASSCO. As of the date of this report, three of the five planned disbursements have been made totaling \$3.8 million. Total funding to date is therefore \$5,067,300.

In late November, 1995, a request has been made by PSSC/PASSCO that the requirements for the fourth and fifth contributions by the RDA (per the 1994 OPA) be waived so that the disbursements can be received by PASSCO. These two disbursements total \$1,400,000. Among the requirements requested to be waived is the stipulation that PSSC/PASSCO secure an agreement with a developer/builder for the Subarea 2C parcel.

On January 9, 1996, City Council approved an amendment to the existing OPA for Subarea 2C, which among other things, provided for the immediate release of \$350,000 to PSSC to fund pre-commencement work necessary to facilitate the physical remediation of the Plant Site. The remaining \$350,000 of the fourth disbursement and all of the \$700,000 fifth disbursement were preserved in accordance for the intended purposes in the original agreement.

Additionally, Bruce Train, on behalf of PSSC, submitted a Motion for an Order Approving Amended and Restated Reorganization Plan (the "Amended Plan") to the Court. A hearing was held on December 15, 1995, and Judge Patel ruled in favor of the Motion in late December.

## **DISCUSSION**

### **Discussion of Parties and Roles**

It is our understanding that the role of the Special Master was originally established to ensure that former employees of PSSC secure health benefits from the sole remaining asset of PSSC: the PSSC Property. In this capacity, the Special Master has begun to perform interim remedial measures on the site to enhance the development potential and marketability of the site in order to maximize proceeds to the Pensioners. It is evident that the Special Master has played a key role, over the past five years, in the cleanup of the site to date and in moving the project through the development process in the past five years. The Special Master has developed an in-depth understanding of all of the intricacies of the PSSC Property and appears to be a driving force in moving the project forward.





However, it is also clear that the role of the Special Master has evolved from that originally established by the Court. In addition to an administrative role, the Special Master has taken on a developer role with respect to the PSSC Property, through the PASSCO and PDC entities. If incentives are structured appropriately, this "ownership" interest could provide incentive for the cleanup and development of the PSSC Property that would benefit all parties. However, Bruce Train's dual role appears to create potential conflicts of interest for the Special Master in that the Special Master's original charge of maximizing benefits for the PSSC employees/retirees and the RDA may be negatively impacted by the role or affiliation with the developer of the project.

Based upon C&L's review of documentation pertaining to the Property and various agreements between constituents, there are a number of confusing relationships among the PSSC parties. Certain of these relationships appear to be problematic and, in fact, may result in incentives to certain parties which are not intended.

*PSSC/Special Master:* The PSSC Property is the only remaining asset of Pacific States Steel Corporation, which ceased operating in 1978. The Company has a significant liability to its former employees (the "Pensioners") who are entitled to receive benefits relating to the Company's Medical Plan. Since 1984, a Special Master, under orders of the Court, has overseen the Company's affairs. In 1990, Bruce Train was appointed Special Master. Bruce Train's interest, in his capacity as Special Master, is to provide benefits to the Medical Plan participants and address the other claims of the Company.

*PASSCO:* This company is wholly-owned and controlled by Bruce Train, Ted Sorensen, and Hans Lemcke. PASSCO is a private company established to provide administrative services to the Special Master. Bruce Train is President of the company. The relationship between PASSCO and PSSC is problematic with respect to certain interactions between the two entities.

First, Bruce Train, in his capacity as Special Master, essentially contracts with Bruce Train, in his capacity as President of PASSCO, for the provision of administrative services. Bruce Train, through PASSCO, considers himself a significant creditor of PSSC.

Additionally, PASSCO and PSSC together will realize profits from the development of the PSSC Property, although PASSCO has not made any equity contribution to the venture.

Furthermore, as PASSCO's incentive as a private company is to profit from the development, PASSCO's interests may not be aligned with PSSC's interests in the development.



***PDC:***

PDC is the development entity which is wholly owned and controlled by Bruce Train, Ted Sorensen, and Hans Lemcke. As such, in his capacity as the lead person in both PASSCO and PSSC, a potential conflict exists with respect to Bruce Train's involvement "on both sides of the table."

Based upon our understanding, PDC is the entity which will, together with PSSC and a builder-partner, form a joint venture to build homes on the Property, and will share development profits with the builder.

In short, PASSCO receives fees for administering the PSSC estate and developing the Property, while PDC participates in the development profit from building homes on the PSSC Property.

The fact that both of these entities are controlled by Bruce Train appears to pose significant conflicts. Additionally, since the interests of these entities in the project differ from that of the Pensioners and the RDA, the interrelationships between the entities may not be in the best interests of the Pensioners or the RDA.

**The Funding Request**

In September 1995, the RDA received the Revised Comprehensive Proposal from Bruce Train, in his capacity as Special Master. The Proposal seeks financial assistance from the RDA to assist in funding the cleanup and redevelopment of the PSSC Property and the acquisition and development of other properties. The aggregate stated amount of the financing request is \$35.75 million, however a variety of additional amounts for contingencies and infrastructure are also requested.

Of this amount of \$35.75 million, the RDA has already approved approximately \$6.47 million in funding in accordance with the 1994 OPA for Subarea 2C and the CIWMB Plant Site Cleanup Grant OPA as detailed below ("Previously Committed Funding"). The total additional request is therefore estimated as \$29.28 million ("Additional Cash Funding Request"). The Proposal further identifies additional amounts (above the \$35.75 million) for funding contingencies and infrastructure ("Incremental Funding Requirements").





The table below details the Previously Committed Funding by the RDA in the 1994 OPA for Subarea 2C and the CIWMB Plant Site Cleanup Grant OPA.

### **PREVIOUSLY COMMITTED FUNDING**

<b><u>Stated Purpose</u></b>	<b><u>Amount</u></b>	<b><u>Status</u></b>
Remediation/PG&E strip acquisition/slag relocation	\$1,216,000	Funded
Remediation	1,302,000	Funded
Remediation	1,282,000	Funded
Remediation (CIWMB)	1,267,300	Funded/Committed
Pre-commencement activities	350,000	Funded
Purchase 2C streets	350,000	Committed
Purchase R.O.W. for Power Line Relocation	<u>700,000</u>	Committed
<b>Total</b>	<b><u>\$6,467,300</u></b>	

The following table details the Additional Cash Funding Request of \$29.283 million outlined in the Proposal which, with the \$6.47 million shown above, total the stated request amount of \$35.75 million. PSSC has requested funding from the RDA for a variety of additional projects which are not included in the \$35.75 million. As such, for clarity, the amounts which comprise \$29.283 million are referred to as the "Additional Cash Funding Request" as opposed to the additional RDA inputs which are requested in addition to the \$35.75 million.

The following details the stated purpose and amount of funding requested.

### **ADDITIONAL CASH FUNDING REQUEST**

<b><u>Stated Purpose</u></b>	<b><u>Amount</u></b>
Realignment of 7th Street	\$1,302,000
Purchase of streets in Subarea 2C	6,500,000
Interior streets in Subarea 5	9,962,000
Future remediation	10,474,000
Remediation oversight	<u>1,045,000</u>
<b>TOTAL</b>	<b><u>\$29,283,000</u></b>





The components comprising the potential required funding in addition to the amounts previously outlined are described below. To differentiate these amounts from amounts that comprise the \$35.75 million, the additional requests are referred to as the Incremental Funding Requirements. Certain of these potential funding requirements are mutually exclusive, so each item noted in this listing will not necessarily come to fruition (for example, if the land swap is not successful, the incremental cost per the proposal would be \$2.5 million, however, the incremental costs associated with the Subarea 7 zoning would not be required if the land swap were not successful). Additionally, it is important to note that the amounts listed are estimates of PASSCO which were identified in the Proposal. As such, these amounts have not been verified or tested for reasonableness by the RDA or Coopers & Lybrand. The PASSCO/PDC estimates, stated purposes, and pages of reference in the Proposal are presented below, Actual amounts may be higher or lower and actual use of funds may be different than those presented. In the Proposal, Bruce Train states that the above amounts are the "...minimum that will still allow us to go forward with the program" of development.



## INCREMENTAL FUNDING REQUIREMENTS

<u>Stated Purpose</u>	<u>Amount</u>	<u>Reference</u>
Cost/inflation adjustment	Unknown	Pg. 5, 5.a.
Construction-11th St & 7th to 11th link	\$2,500,000	Pg. 5, 5.b.
Subarea 7 zoning	\$0 to \$2.5 million	
Subarea 7 zoning - [RS(s) zoning]	\$1,250,000	Pg. 6, 5.c.
Subarea 7 zoning - [4500 sf lots]	\$1,750,000	Pg. 6, 5.c.
Subarea 7 zoning - [6000 sf lots]	\$2,500,000	Pg. 6, 5.c.
Unsuccessful land swap	\$2,500,000	Pg. 6, 5.c.
Property tax interest/penalty abatement	\$920,000	Pg. 6, 5.d.
Obtain land for PG&E power lines	Unknown	Pg. 7, 2.d.
Fee credit- PG&E power lines	\$810,000	Pg. 7, 2.d.
Fee credit - 7th St. alignment	\$1,302,000	Pg. 7, 2.e.
Fee credit - SR84 local match, if any	Unknown	Pg. 8, 3.c.
Obtain land for ACFCF channel	Unknown	Pg. 7, 2.g.
Relocate ACFCF channel	Unknown	Pg. 7, 2.g.
Low/Mod housing subsidy	\$623,400 to Unknown	
Subsidy for 12.5% profit margin	Unknown	Pg. 8, 3.e.
Land acquisition (2-3 ac @ \$311,700)	\$623,400 to \$935,100	Pg. 8, 3.e.
Remediation of Old Corporation Yard	Unknown	Pg. 9, 1.
Obtain Old Corp. Yd to convey to PSSC	Unknown	Pg. 9, 1.
Obtain Area 7 to convey to PSSC	Unknown	Pg. 9, 1.
Maintenance of public parks	Ongoing/Unknown	Pg. 7, 2.a.





## **Conceptual Issues**

This section is intended to outline certain conceptual issues identified with respect to the feasibility of the Proposal as presented. The parties who have been actively involved in the overall project, including the City, the RDA and the Special Master, have significant background, experience and familiarity with the project and may have considered or addressed the following issues. However, in our preliminary analysis we have attempted to identify certain issues that could negatively impact the feasibility of the proposed PSSC Project or portions of the project as currently envisioned.

### **Land Swap Transactions**

Certain components of the land swap transactions among PSSC, Union City, the RDA, ACFCD, Catellus and Caltrans appear to be unrelated to the remediation of the Plant Site. Furthermore, the uncertainty with respect to the State Route 84 matter will dictate the current motivation of participants and may ultimately impact the land swap structure.

Development of Subarea 7, which is outside the DIPSA (and the Redevelopment Agency Project Area), does not provide a direct benefit to the DIPSA, the Plant Site, the RDA or the Pensioners. The benefits resulting from this component of the land swap will profit PASSCO/PDC, as they develop the Subarea 7 site for single family residential housing. As contemplated, the end result of the transactions will be that PSSC will own Subarea 7, which is outside of the RDA's Project Area, although the RDA may be responsible for costs associated with its acquisition and development per the Proposal.

Ted Sorensen stated that without allowing PSSC to obtain Subarea 7 via the swap, there is "no incentive for us to remain interested in the Plant Site after Subarea 2C is developed." Similarly, acquiring Subarea 7 enables PASSCO/PDC to enjoy development profits, but does not provide incentives, funding, or profits to assist in the development of the Plant Site. Proceeds from the sale of the parcels or profit from the development of homes on these sites (Subareas 2C and 7) do not flow back to the Plant Site per the Gap Funding Analysis.

Additionally, based upon C&L's review of the development plan, it is our observation that the areas with the highest development potential (Subarea 2C and Subarea 7) are scheduled to be developed first. The Plant Site, which is the last area to be developed, will likely generate the lowest development returns due to its proposed uses which include public park areas, required infrastructure and environmental concerns. The land swap appears to focus the efforts of PASSCO/PDC on the areas which can quickly provide profits from the development of the parcels through home-building (which will go to PDC and a joint venture developer) and not on the redevelopment of the Plant Site.





## **Project Time Frame**

The Proposal calls for a relatively short time frame with respect to (i) the completion of the remediation of the Plant site, (ii) the completion of the land swap transaction and, (iii) the completion of the infrastructure work on the project. This estimated time frame appears to be aggressive given the unpredictable nature of environmental cleanup projects, complex land swap issues, and issues surrounding State Route 84.

As Bruce Train points out in the Proposal, "...any delay in this time schedule will cause an increase in costs due to additional holding and inflation costs". This increase in costs would likely be borne by the RDA. In fact, with respect to the most immediate progress required on the project, the Plan calls for beginning development of Parcel 2C this summer. Based upon our understanding of the status of negotiations with a builder-partner, the NHUSD settlement negotiations and issues relating to the relocation of the power lines, PSSC/PASSCO will be hard-pressed to meet the proposed schedule.

## **Parcel 2C Development versus Sale**

The Proposal indicates that Subarea 2C is essentially clean and, after the settlement of the NHUSD negotiations and the removal of the power lines, will be ready for development. It is our understanding that while development is scheduled to commence in Summer 1996, a joint venture agreement with a builder has not yet been obtained by PSSC/PASSCO for the development of the parcel. Furthermore, it is our understanding that PSSC/PASSCO has been in litigation with two separate builders with whom it had entered agreements for the development of Subarea 2C. A concern must be raised regarding the ability (and time required) for PSSC/PASSCO to secure a relationship with a builder.

This parcel (Subarea 2C) is purported to have the highest development value. This raises the question as to why the parcel is not sold to a developer who is independent and has experience in real estate development, with the net proceeds used to pay liens on the property, fund further cleanup of the Plant Site or provide payment to the Medical Plan. The effort to provide incremental development profits for the benefit of the estate seems risky, given the lack of experience in this capacity by PSSC/PASSCO.

## **Fremont Parcel**

The second borrowing from Doolittle of \$265,000 resulted in a lien on the Fremont parcel. Additionally, the Fill Supply Agreement has created a second lien on the parcel in the amount of \$243,750. The KMA Opinion of Value for the 1.26 acre parcel is in the range of \$353,000 to \$450,000 (per the Proposal). The Hulberg Appraisal, prepared on behalf of the RDA, ascribes a value of \$165,000 to this parcel. The two liens total \$508,750, which is significantly greater than the parcel's value.



## **PSSC Indirect Environmental Costs**

The Forecast of Remediation Expenditures on the PSSC Property includes \$7.248 million in Administration and Other costs, which represent 25.3% of the Direct Environmental Costs of \$28.595 million outlined in the Proposal. The forecast of environmental indirect costs appear high as a percentage of direct remediation costs.

## **Financial Considerations**

This section addresses observations relating to the financial issues which are outlined in the Proposal. These items are identified based upon C&L's review of the Proposal and present issues that appear to need clarification or further analysis in order to appropriately assess the impact to the RDA.

### **General Presentation of Sources and Uses of Funds**

The overall presentation of the source and use schedule is complex, and is not presented in a clear manner, or in a format which resembles a typical real estate development pro forma.

It appears that the schedule is intended to reflect expenses incurred (whether paid or deferred) since 1989, current obligations of PSSC and projected future expenditures. In the sources, the \$35.75 million RDA funding appears to include fundings to date (per OPA's) as well as anticipated future fundings. However, it does not appear that the sources of funds from the Fidelity or Doolittle loans or proceeds from the sale of land to the Gregory Group, Inc. are reflected in the schedule. The reference point in time of the schedule is not clear. The schedule could be misleading to the extent that uses of funds, such as environmental clean-up costs or administrative fees were paid from sources that are not reflected on the schedule.

### **Correlation of Funding Request to Sources and Uses Schedule**

The summary funding request for \$35.75 million outlined on page 4 of the Proposal under "Proposed 1995 OPA Amendments" presents a summary of intended uses for the RDA funding. This includes the 1994 OPA, the CIWMB OPA and future funding for Subarea 2C and Plant Site development. It is not clear how this funding summary ties to the sources and uses of proceeds outlined in the Gap Funding Analysis presented in Attachment VI-4 of the Proposal.

The lack of correlation between the two schedules creates confusion with respect to the use of the RDA funding. For example, it is not clear how the \$6.5 million for "the purchase of streets in Subarea 2C" on page 4 of the Proposal is reflected in the sources and uses schedule.





Additionally, the Proposal indicates that PSSC will contribute \$10.248 million or 28.5% of the funding to the project. The composition of that amount is unclear from the sources and uses schedule, as the amount does not appear to be included.

### **Timing of Sources and Uses of Funds**

The schedule included in the Gap Funding Analysis (Attachment VI-4) is presented on a static basis and does not address the timing of sources and uses throughout the development period.

The schedule could be materially misleading. To the extent the uses of funds are required before funding is available, the development and/or completion of the project could be in jeopardy. C&L has met with PASSCO personnel on two separate occasions to discuss the financial statement and has requested a pro forma analysis. Ted Sorensen indicated to C&L that it "couldn't be done." In C&L's numerous years in the industry, it is our experience that pro forma cash flow analyses are performed on all development projects of any significance.

### **PSSC/PASSCO Gap Funding as Source of Funds**

The Gap Funding Analysis indicates that PSSC/PASSCO will contribute \$3.0 million toward the Rust Remedial Services outstanding balance, along with additional funding of \$13.287 million. It is not clear when or how the \$3.0 million will be contributed, and the \$13.287 million is scheduled to come from future profits or non-payment of fees. If these sources of funds are not actually available at the time the use of such funds are required, the development schedule, and, in turn, the RDA's exposure could be negatively impacted.

Additionally, PSSC/PASSCO characterizes Rust's services for Subarea 2C as a PSSC/PASSCO "input" to the project since PSSC/PASSCO contracted for Rust's services. These services resulted in a secured lien on Subarea 2C and an option to place a lien on the Plant Site. To the extent development proceeds or other funds available to PSSC/PASSCO are applied to pay this debt, they are not otherwise available for the cleanup and remediation of the Plant Site, thereby increasing the required RDA assistance for cleanup on a dollar for dollar basis. Consequently, this could be viewed as an RDA input, not a PSSC/PASSCO input.

### **Compensation Structure**

#### **Development Fees to PASSCO/PDC**

The Proposal provides for Development fees to PASSCO in two formats: first on an hourly rate basis, and second as a value enhancement fee. Total hourly rate development fees, including paid, deferred and projected fees approximate \$7.7 million. The projected value enhancement fee proposed in the Plan is \$12.3 million.



The developer of the project, whether it is PSSC/PASSCO or a third party entity, should be compensated for services provided in accordance with market rate fee structures, considering the nature of the project and the capital at risk. The development fees for this project, which include hourly rate compensation and profit on the project, are not typical of real estate development fee structures.

The value enhancement fees appear redundant since PSSC/PASSCO already has a fiduciary responsibility to maximize the value of the estate and is also presently at risk for collection of a portion of its fees to date. In its fiduciary capacity, PSSC/PASSCO would be expected to undertake the development effort (if it believed this would yield the highest value) to generate the funds to repay its current and past fees, without an additional carrot of enhancement fees.

The risks to the Administrator are absolved by the Court. While a risk does exist regarding the collection of past fees, future efforts will be compensated from the Doolittle borrowings and the RDA funding (if approved). As the Administrator is not putting any new capital at risk, we do not understand why it is entitled to an equity risk return, while the RDA or new outside financiers will be required to put funds at risk. The KMA report indicates that the RDA funding is the primary element which will add value to the Plant Site. It would appear incongruous for the Administrator to be rewarded for efforts that are actually attributable to public sector funding.

The value enhancement fee is derived based upon 40% of the land value, according to the Proposal. However, the concluded land value of \$30.7 million is based upon KMA's concluded value grossed up by PSSC/PASSCO for the special DIPSA development fees. The calculation of the value enhancement fee on the "grossed up" value of the property inflates the total amount of this participation fee.

Furthermore, with the proposed funding by the RDA, PASSCO/PDC does not have the capital risk that an owner/developer would have in a typical land acquisition/development deal. While Bruce Train states in the Funding Proposal that PSSC/PASSCO is contributing \$47 million toward the estimated DIPSA costs of more than \$85 million, these amounts do not constitute actual cash inputs by PASSCO. The "inputs" contributed by PSSC/PASSCO include the value of the land of \$30.7 million, which reflects the added value of remediation and infrastructure provided through the contemplated RDA funding, and future development profits of PASSCO.

### **Environmental Oversight Fees to PASSCO**

Per the terms of the Proposal, PASSCO is to receive environmental oversight fees. These amounts, including paid, deferred and projected hourly rate fees, total \$6.9 million. On the surface, these fees appear to be quite high as a percentage of total remediation costs.





### **Administrative Fees to PASSCO**

Per the terms of the OPA, PASSCO is to receive hourly fees from PSSC for administration of the PSSC liability. Based upon the classification of Other hourly fees, these amount to \$4.6 million, including paid, deferred and projected fees. While administrative fees to a receiver or fiduciary are normally found in the marketplace, it is highly unusual for the fee to be billed on an hourly basis, particularly for a project of this duration. Bruce Train's roles with respect to both entities creates questions with respect to the establishment and payment of this level of administrative fees.

It is our experience that parties serving similar or more risky roles, with much greater responsibility and exposure to loss, are compensated on a salaried basis which is substantially lower than the sum of the hourly rates presented by PASSCO. In the marketplace, salaries for turnaround specialists in CEO capacities range from \$250,000 to \$600,000 per year. Frequently, these compensation structures have a low base or a deferred portion of compensation and an incentive payment tied to results or completion of a restructuring. Significantly, compensation is very often tied to the value created or funds distributed.

### **Medical Plan Obligation**

The Special Master has proposed an amount of \$9 million as the amount PSSC can pay toward its liability for the Medical Plan. Of this amount, approximately \$1 million represents legal fees. In the Report and Accounting of Special Master (November 1, 1995) ("the Report"), it is stated that the "Special Master concluded that there was no realistic possibility of satisfying the massive obligations of PSSC to the Medical Plan...", however no actuarial or other calculation is provided to determine the magnitude of the actual liability. No evidence is provided as to how the Medical Plan obligations were estimated at the time that PSSC ceased operating or any indication of the true amount of the current liability.

### **Priority Structure of Proceeds - Medical Plan**

Per the terms of the Proposal, the hourly rate developer fee and 50% of the developer profit is paid prior to payment of the Medical Plan liability. Additionally, the developers receive any profits as a result of the development of the property after the payment of \$9 million to the Medical Plan.

The role of the Special Master was established to develop the site so as to provide benefits from the proceeds of the asset to the Pensioners. As claims on the PSSC Property mount, including fees to PASSCO and affiliated entities, the Pensioners are actually moving farther down the line of priority payment.



## **The Role of the Redevelopment Agency**

The purpose of redevelopment is to eliminate blight and to promote economic development, and is primarily directed toward urban areas in which market forces do not provide adequate development incentives. Typically, redevelopment projects can be characterized as "infill" projects, meaning that they are directed toward development in mature areas.

In Union City, per the Redevelopment Plan, redevelopment is geared toward promoting neighborhood revitalization, economic development and affordable housing. Specifically, the Union City RDA seeks to eliminate or reduce the blighted conditions in an identified Project Area within the City. The Project Area consists of 1,486 acres of primarily commercial areas throughout the City, as well as residential neighborhoods, industrial areas and public facilities. The identified sub-areas total thirteen distinct areas located throughout the City.

The RDA's goal is to bring development projects to fruition when market forces alone may not be adequate to attract for-profit development through the partnering of public and private sectors. The RDA achieves this goal through addressing issues which inhibit development, including facilitating the construction of public improvements such as streets and utilities, remediating toxic contamination, and rehabilitating physical deterioration of property, among other efforts.

The majority of the RDA's efforts and direction of redevelopment funds over the five-year period beginning December 1994 are aimed toward the DeCoto Industrial Park Study Area. The RDA's Five-Year Implementation Plan provides for \$11.8 million in non-housing expenditures, of which \$6.7 million is targeted toward the DIPSA. The DIPSA is a 313 acre portion of the Project Area designated for residential, commercial and industrial uses. The objectives of the RDA with respect to the DIPSA can be categorized into four program activities:

- Public Infrastructure
- Public Facilities
- Economic Development
- Property Acquisition and Cleanup

Specifically, the RDA will direct its efforts in the DIPSA toward certain objectives:

- supporting efforts for development of infrastructure which otherwise limits opportunities for achieving land use objectives,
- designing and implementing improvements to the Seventh Street corridor, with appropriate land uses supporting circulation routes,
- supporting the construction of Route 84 extension as a partially depressed and at-grade expressway,
- providing necessary facilities to address the DIPSA flood hazard with minimal disruption to land use pattern,
- designing flood improvement project to be part of open space system of the DIPSA,
- encouraging, and when necessary financially support, timely cleanup of contaminated sites.

A portion of the DIPSA site is represented by certain parcels of land owned by PSSC which is the focus of this report.





The RDA Advisory Committee and Agency Board are currently evaluating RDA priorities for agency resources.

### **Appropriateness of RDA Provision of Funding**

In his September 25, 1995 letter to Mark Lewis, the Special Master succinctly stated that "...the RDA cannot be asked to provide any funds to PSSC for the project in excess of the minimum required contribution to achieve success in a commercial context."

It is our understanding that the overall mission of the RDA is to assist in the redevelopment of projects within the City. The subject project has many additional considerations and obligations that need to be satisfied (i.e., the medical liability of the Pensioners, the Rust obligation) which are beyond the realm of the RDA's responsibility.

### **RDA's Ability to Fund Project**

In order for the RDA to be able to provide the gap financing amount requested, the RDA would be required to amend its fiscal agreement with the County. If the RDA is not successful in amending the fiscal agreement with the County, or if the estimated costs associated with the cleanup and development of the project exceed those identified in the Proposal (i.e., due to contingencies or other funding obligations on the RDA imposed by the Proposal), the timing and/or completion of the project could be negatively affected. Furthermore, if the requested level of funding outlined in the Proposal (\$35.75 million) is provided by the RDA, funds available for other RDA projects will be severely restricted.

### **Prohibition of RDA's Funding of Past Expenditures**

The RDA has no obligation, and is legally constrained in its ability to pay Rust for past services for which the Agency did not contract. However, to the extent future development profits and land sale proceeds from Subarea 2C are applied by PSSC to repay Rust, they will not be available for Plant Site remediation and infrastructure. This will result in a dollar for dollar increase in required RDA funds.

### **RDA Responsibility for Contingencies**

In accordance with the terms of the Proposal, the RDA could be required to fund additional amounts for contingencies and infrastructure, such as development costs based upon the ultimate zoning of Subarea 7. First, a requirement that the RDA fund contingencies may provide the wrong incentives for the developer, since the RDA would be obligated for expenditures outside its control.



Specifically, with respect to Subarea 7, the parcel is unrelated to the PSSC Property or the RDA's Project Area. It is not appropriate that the RDA be required to fund contingencies in Subarea 7 unless this funding furthers the goals of the RDA (ie., the development of the Plant Site).

### **Performance Criteria and Measurement**

The 1994 OPA for Subarea 2C was task-based, and the release of financing proceeds was based upon performance of defined tasks rather than tied to costs incurred in performing such tasks. It appears that as tasks were completed in accordance with the 1994 OPA for Subarea 2C, funds were released and used for interim purposes, resulting in current outstanding obligations of PSSC. It is unusual to see funding provided without specific designation for use of proceeds. The subsequent CIWMB Plant Site cleanup grant OPA was more appropriately structured such that released funds were applied to costs incurred in performing the specific tasks outlined in the OPA.

Per the RDA, the ultimate purpose for which the RDA has provided funds to PSSC through the 1994 OPA for Subarea 2C and the CIWMB Grant OPA are legally authorized under CRL. The RDA has obtained a first position deed of trust on fully remediated property in DIPSA Subarea 2C with value (per the Hulberg and KMA appraisals) in excess of the disbursed and committed funds to assure and enforce performance by PSSC of the obligations under the 1994 OPA for Subarea 2C. The CIWMB Grant OPA requires that performance occur prior to the release of funding.





## FUTURE STEPS

The following are general recommendations relating to the Proposal which C&L considers to be the most important future steps. These recommendations are not intended to promote an eventual course of action with respect to the Proposal, but highlight certain areas in which the RDA should investigate further.

- The RDA should gain an understanding of the amount and timing of development cash flows, the cash contributions by various parties, and the allocation of proceeds and profits. It is advised that the RDA request a more typical development pro forma than the Sources and Uses schedule provided.
- The RDA should gain a complete understanding of all proposed transactions relating to the development and their bearing on the RDA's goals. Specifically, the RDA needs to understand how the acquisition of Subarea 7, which is outside the defined Project Area, benefits the Plant Site or provides funds for the development of the Plant Site.
- While we understand that the RDA hopes that the Pensioners receive an equitable share of the development profits from the PSSC Property, this consideration is out of the realm of the RDA's jurisdiction and objectives. Per the Proposal, the Pensioners would receive a maximum of \$9 million from the development of the PSSC property and would not be entitled to any excess residual value of the Property. To this end, it is suggested that the RDA investigate whether payment of claims should more closely mimic other transactions of this type in the marketplace.
- The RDA should investigate the appropriateness of following the principal of maximizing net present value on its investment in the DIPSA. For example, we recommend evaluating the economic impact of the sale of the Subarea 2C parcel in accordance with the value conclusions per the KMA and Hulberg appraisals and the use of the sale proceeds to satisfy liens on the parcel and pay other obligations of the project. As it appears that profits from the building of homes on this parcel do not flow back to the Plant Site, the maximum value to the RDA and the Plant Site may be through an outright sale. This analysis can then be compared to the sources and uses of funds presented in the Proposal to evaluate the value of each.
- The RDA should perform the following surveys:
  - a survey of other public/private ventures which have realized success on complex projects. By gaining an understanding of the incentive structure of other public/private partnerships, the RDA can devise an incentive program that rewards project completion which would be beneficial to all parties.



- a fee survey to evaluate the appropriateness of the various levels of fees to PASSCO. The Development fees, Project Oversight fees, Administrative fees, and Indirect Environmental Costs appear to be excessive as a percentage of overall costs and should be benchmarked against industry standards. In investigating the fees, consideration should be given to the relevant development experience of PASSCO as well as the specific individuals' knowledge and familiarity of the project.
- With respect to future Owner Participation Agreements, the disbursement of funds should be tied to specific payment of obligations incurred in connection with the performance of specified tasks rather than the performance of the task. This structure, similar to that of the CIWMB Plant Site Cleanup Grant OPA, would ensure that funds are not used for alternative purposes in lieu of payment for specific tasks. The RDA should exercise audit rights with respect to payment of any obligations. This will eliminate the "accrual" of fees and obligations associated with the performance of such tasks while the actual cash proceeds are used for alternative purposes.

## **CONCLUSION**

It is important to note that this analysis of the Proposal and the summary of our observations presented herein is intended to be an evaluation of the documents reviewed. Our level of knowledge with respect to the history of the project, the parties involved and the ownership and financing structure of the Proposal is based on our review of the documents provided and discussions with representatives from the City and PASSCO.

Other than reviewing the documents provided, we have not performed any detailed financial analysis with respect to specific aspects of the Proposal, such as evaluating actual expenses to date or analyzing the specific components of the sources and uses of funds.

It is hoped that this analysis is not construed as minimizing the significant contributions to date made by the Special Master with respect to the remediation and development of the project. Rather, the focus is to evaluate the Proposal to understand the impact on the RDA and to ensure that all parties to the project are compensated appropriately for the contributions made and risks incurred.





**ADDENDUM**

**OBSERVATIONS REGARDING THE AMENDED PLAN OF REORGANIZATION**



## **OBSERVATIONS REGARDING THE AMENDED PLAN OF REORGANIZATION**

At your request, C&L has analyzed the Amended and Restated Reorganization Plan (the "Amended Plan" or "Plan"). The development and financing provisions put forth in the Plan are significant because they have substantial impact upon the Proposal. If the Plan is approved by the Court, it may have the effect of influencing the manner in which the RDA responds to the Proposal. For this reason, it is of great import that the two documents are viewed as a single proposal in effect.

The timing of the submission of the Amended Plan is unusual. It appears premature that the Special Master submitted the Plan to the Court while the issues surrounding the RDA's project funding have not been resolved. Additionally, to the extent that the Plan is approved, it is unclear whether the Plan has the effect of modifying the prior OPA's. The Agency is not bound by the Amended Plan, however the ultimate structure of Agency assistance to PSSC has significant impact on the Plan. As such, the terms and conditions of Agency funding, which may impact the rights and treatment of parties, would require further court approval. It is our understanding that the RDA neither supports nor opposes the Plan.

The following section provides C&L's comments with respect to the Amended Plan. To the extent that issues relate to both the Plan and the Proposal they are addressed above, but may be commented upon in the following as they relate to the Amended Plan.

### **Overall Objectives of Amended Plan**

The objectives listed do not seem to tie to the allocation of proceeds nor the effort to determine the actual amount of the medical plan liability.

### **Court Oversight of Special Master**

It is unusual that five and one-half years have passed since the time of the last report on implementation of the Plan of Reorganization. This practice eliminates any effective oversight of the role and efforts of the Special Master by the Court, the Creditors or other parties in interest. This lack of reporting is not typically acceptable in a Bankruptcy Court context or in most Receiverships. It would be useful to review the Order Appointing the Special Master to gain an understanding of the reporting requirements which were put in place at the outset.

### **PBGC Claim**

There is a reference in Paragraph 15(f) of the Report to an estimated claim of \$6.8 million plus interest from May 1, 1990 due the PBGC. We have been involved in other cases in which the PBGC demanded and was granted priority of treatment over all other creditors in the case. In the past, this agency has not been shy in enforcing what it sees as its rights in similar situations and the PBGC could effectively block the implementation of the Amended Plan as submitted by the Special Master.

This may be an important issue for the RDA as it is unclear how the PBGC opposition would impact the RDA since per the Proposal, the RDA will be responsible for unknown contingencies.





### **Priority Structure of Claims - Administrative Claims**

The Administrative Claim priority structure provides for priority payments to fiduciaries. Under this structure, there would be incentive for the fiduciaries to incur costs, and build up an administrative priority claim, and then to sell the monetizable assets to satisfy the administrative claim, with little payment to existing creditors.

Additionally, it is unclear from reading of the Plan as to whether the Special Master considers the RDA lien on the PSSC property as an Administrative Claim.

### **Treatment of Claims**

The requirement that future Tier 1 Administrative claims must be fully provided for before any distributions to Tier 2 claims appears to indicate that any distributions to lower priority claimants will occur at the end of all development by the Land JV and remediation of the sites.

In Section 3.4.2, it appears that PASSCO will continue to receive a priority of payment as a Tier 1 Administrative Claim, as well as the catch-up on the deferred fees of PASSCO to the Threshold Amount, to the detriment of other deferred Tier 1 claimants.

### **Project Financial Statements**

There are references in the Amended Plan to cash expenditures to Creditors and to large cash payments by PSSC. Without an understanding of prior payments to creditors as well as to PASSCO, it is difficult to adequately assess the Plan of Reorganization and its treatment of creditors and other constituents. Quarterly (or annual) balance sheets would provide insight into the accumulation of billings over the several-year period.

In general, it would be useful to present cumulative revenues and expenses on an accrual basis. This would enable the RDA to evaluate the true cost of financing shown on the schedule and the actual operating cost of sustaining the PSSC estate for each period.

### **Kenneth Leventhal ("KL") Testing of Disbursements**

The specific testing as outlined in the KL report is far short of the testing performed in an audit of financial statements. The Procedures identified with the cash receipts and disbursement schedules are unclear as to the level or the number of items selected for testing. Additionally, KL verified the mathematical accuracy and completeness of the schedules of receipts and disbursements and bank accounts, but did not evaluate the reasonableness of the underlying charges or costs. As such, we are unable to determine level of reliance that should be placed on the KL report.



### **Payments to Related Parties**

Paragraph 24 of the Report refers to the "complete elimination of all compensation paid to Train, Sorensen, and Lemcke personally." The PASSCO schedule of billings and payments contradicts this statement: The schedule shows approximately \$300,000 being paid to the three individuals over a period of nine months in 1995.

### **PSSC Administrative Expenses**

A lien has been placed on Parcel I-A of the Property to fund the administration costs of PSSC which were funded through Chemwaste/Rust. Is it appropriate that the Property has been pledged as collateral for PSSC administrative expenses through the Chemwaste/Rust arrangement and second trust deeds?

### **Special Master Fees**

It appears that the Gregory Group, Inc. ("GGI") and the former Special Master were effectively paid their fees for services as Special Master through a transfer of the Fremont Property to them. The GGI transaction may be summarized as follows: a cash inflow to PSSC of \$3.4 million in March 1, 1989, a second cash inflow from GGI of \$320,000, cash outflows to the former special master from March 1989 through December 1990 of as much as \$3.6 million, and transfer of a parcel of land ready for development for no additional consideration. This Fremont property appears to have been worth \$3.5 million to \$7 million (based on lot value of \$50,000 to \$100,000).

### **PASSCO Fees**

We are unable to determine the composition of the fees to PASSCO. The fees are not broken out between fees for services of the three principals versus administrative costs for operating the company.

### **Acquisition of the DeLucchi Parcel**

The Amended Plan indicates that the right to acquire the DeLucchi Parcel will be transferred to the Land JV. In the event of acquisition of the parcel, absent the transfer of any other consideration, if the Land JV immediately resold the parcel for more than the option price, the Special Master would receive half the profit with little action toward adding value.

### **Additional Doolittle Loan**

The Amended Plan enables the Special Master to draw an additional \$265,000 from Doolittle, but the Plan document does not identify the cost of the loan, the means and term of repayment, or the application of proceeds of \$265,000. If this loan is similar to the earlier Doolittle loan, it will be costly and the estate should evaluate the need for funds on this basis before committing its assets towards this financing.





### **Fill Agreement of Subarea 2C**

We understand the necessity of entering into an agreement to provide for the clean fill required for the Subarea 2C, but we are troubled as to why Double D would accept a deferment of payment with a second trust deed well in excess of the KMA values as its only security. Is there some other collateral or side agreement involved in this transaction?

### **PASSCO Service Agreement Termination Provisions**

If PASSCO's service agreement is terminated, all PASSCO fees become the top priority for repayment, behind only the liens of Rust and Doolittle. This poses two problems: (1) what is the priority of the RDA lien in this event, and more importantly, (2) this provision effectively prevents any party from dismissing PASSCO for "cause" in the future, due to the onerous impact of the priority clause.

### **Special Master Privileges**

The Special Master privilege enabling the Special Master to determine claims on an arbitrary basis is highly unusual and does not provide Creditors any reasonable means of recourse. As proposed, the Special Master may set a creditor's claim amount, and (it appears) without any notice to the creditor. The "appeal" process, combined with the extremely short period identified for preparation of a written response to the Court (10 days from date of mailing), does not give a creditor any reasonable rights to deal with the Special Master's determination of claims. The provision also allows the Court to forego setting a hearing which also hinders the Claimants' opportunity to present support for a claim.

### **Access to Books and Records**

Section 5.2 describes the limitations placed on access to books and records. These limitations appear to be an effort to eliminate disclosure of the details of records and activities of the Special Master. This is unusual and virtually unheard of in the fiduciary role of a Special Master. At a minimum, there is generally an audit requirement for the accounting and reporting of Special Master activities provided as an independent verification of the accuracy of the records and disclosures.

### **Reporting Process**

The reporting process described in Section 5.3 is not timely and does not provide a level of detail which would enable parties to assess the activities or progress toward implementation of the Amended Plan. The monthly reports should be prepared within 20 to 30 days following each month, and the annual report should be filed within 45 to 90 days after the year end. These annual reports should be prepared on an accrual basis and audited by an independent CPA.



### **Approval of PASSCO Fees**

Section 5.3(d) appears to grant PASSCO automatic approval of its fees without any further action. The level of detail required in PASSCO billings is not adequate for parties to evaluate the substance, value or benefits to the estate of the PASSCO billings.

### **Special Master Release**

The Special Master will receive a release from all claims related to his service as a Special Master, with no limitation of the release for inappropriate actions on behalf of the Special Master (i.e., negligence, gross negligence or fraud).

### **Statement of Special Master in Support of the Proposed 1995 Amended Plan**

#### **Development Potential of Subarea 2C**

Subarea 2C is described in Section 4.1.2 as ready for development shortly after approval of the Amended Plan and a new OPA. This parcel is purported to have the highest development value. This raises the question as to why the parcel is not sold to a developer who is independent and has experience in real estate development, with the net proceeds used in further cleanup of the Plant Site or payment to the Medical Plan. The effort to provide incremental development profits for the benefit of the estate seems risky, given the lack of experience in this capacity by the Special Master.

#### **Transfer of Subarea 2C**

The provision for transferring Subarea 2C to the Land JV does not make clear the transfer price. This is critical for determining the allocation of benefits. It is also of concern that although Subarea 2C will be transferred into the JV, of which PSSC is partner, there will not be any proceeds to the PSSC estate until the JV, which is controlled by PDC, sells acreage for development or pursues complete development (i.e., builds homes) on the parcel. If there are delays in the development project, this raises the specter that, given the level of overhead incurred by PASSCO, there will be little profit or proceeds available to PSSC.

#### **Lack of Prohibition Regarding Competition**

Section 5 contains release language that is overwhelming in its breadth and allows PDC or PASSCO to engage in competitive practices which may be harmful to the Land JV.

#### **Plan Feasibility Not Demonstrated**

The feasibility analysis of the Amended Plan appears to be based on a comparison of full-scale development with a quick liquidation of the property. It would appear certain, since the Amended Plan relies on substantial external funding by the RDA, that additional value will be created by the Amended Plan and made available to pay creditors, regardless of position of priority. Thus, the Amended Plan should create greater value and enhance recoveries.



The materials do not present a set of projections of cash flow or activities which will demonstrate feasibility and achievability. The statement does not make a case for feasibility in terms of achievability of the Amended Plan procedures or convince the reader that the new plan is the "only feasible" way to proceed.

### **Fairness of PASSCO Compensation**

The arguments presented regarding the Fairness of the PASSCO compensation are not compelling in the context of the services of a full time Special Master or equity receiver. The full time effort of the three principals of PASSCO produce annual billings of \$1,369,000 (based on 1800 normal billable hours). There is no risk of loss from lawsuit, virtually no risk of fees not being approved, and no oversight by any party of the adequacy of fees and reasonableness of value of services. The only risk would appear to be that of collection (although the interest of 10% would appear to mitigate the delay in payment). This is an extraordinary sum to pay for services of three individuals for an estate that has no employees and which consists of land parcels totaling approximately 80 acres.

It is our experience that parties serving similar or more risky roles, with much greater responsibility and exposure to loss, are compensated on a salaried basis which is substantially lower than the sum of the hourly rates presented by PASSCO. In the marketplace, salaries for turnaround specialists in CEO capacities range from \$250,000 to \$600,000 per year. Frequently, these compensation structures have a low base or a deferred portion of compensation and an incentive payment tied to results or completion of a restructuring. Significantly, compensation is very often tied to the value created or funds distributed.

### **Value Enhancement**

The value enhancement fees appear redundant since PASSCO already has a fiduciary responsibility to maximize the value of the estate and is also presently at risk for collection of a portion of its fees to date. In its fiduciary capacity, PASSCO would be expected to undertake the development effort (if it believed this would yield the highest value) to generate the funds to repay its current and past fees, without an additional carrot of enhancement fees.

The risks to the Administrator are absolved by the Court. While a risk does exist regarding the collection of past fees, future efforts will be compensated from the Doolittle borrowings and the RDA funding (if approved). As the Administrator is not putting any new capital at risk, we do not understand why it is entitled to an equity risk return, while the RDA or new outside financiers will be required to put funds at risk. The KMA report indicates that the RDA funding is the primary element which will add value to the Plant Site. It would appear incongruous for the Administrator to be rewarded for efforts that are actually attributable to public sector funding.

### **Medical Plan Liability**

The Special Master indicates the Medical Plan liability cannot be forecast in a meaningful way. We would disagree and recommend that health actuaries be engaged to provide a





valuation of this obligation, with assessment of the annual funding requirements. The Special Master should also explore the options for purchase of insurance to cover all or a portion of this cost.

### **Community Benefit**

The Special Master indicates the result of the Plan will be remediation of the PSSC Property, producing substantial benefits to the local community. However, the demand for funding from the RDA, which will absorb all value created in the form of tax increments, appears to negate the positive economic impact of this Plan for the community.

### **Exhibit C**

We note that no amounts have been paid by the present Special Master into the Medical Plan during the five years of his tenure. In fact, no payments have been made to the Medical Plan since January 1990. During this time, the Special Master has collected over \$6.2 million in funds for oversight and cleanup of the property of the estate. Also during this period, the Special Master has paid out almost \$2.6 million in fees to itself for oversight.

### **Exhibit D**

The schedule of PASSCO billings lacks detail and does not present adequate information to evaluate the nature of the billings, the services rendered, the cost reimbursement, or the value created or benefit to the estate from the services. This level of billing should not be relied upon for any determination of the reasonableness of the fees of the Special Master. The application of a 10% rate of interest on past billings should also be assessed in terms of a market rate for such obligations.



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